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**From:**

**Sent:** Wednesday, March 24, 2010 7:23:41 PM

**To:**

**Cc:**

**Subject:** RE: FTC

Nice to hear from you. You are on the right track here. Compulsory payments of creditable foreign income taxes are eligible for credit in the year paid or accrued, according to the taxpayer's method of accounting for foreign taxes. However, under section 904, the credit may be claimed in that year only to the extent of the pre-credit US tax that would otherwise be due on the foreign source taxable income in the same section 904(d) separate category or "basket" to which the foreign tax is apportioned under the rules of Treas. Reg. 1.904-6. If the pre-credit US tax attributable to the taxpayer's separate basket income is less than the amount of creditable foreign tax paid or accrued in that year, then the excess credit may be carried back to the immediately preceding year and then carried forward to each of the following 10 years until the excess is absorbed or expired.

The taxpayer's ability to use the excess credit in a carryback or carryforward year is limited in each year by the section 904 limitation. So if the taxpayer had foreign source taxable income in the general category in        but did not pay or accrue any foreign tax in        (and had no excess credits in the general category carried forward to        from prior years), then some or all of the general category excess foreign taxes paid or accrued in        may be carried back and used as a credit against the US tax on the general category foreign source income that was taxable in        . The carryover and carryback rules help mitigate the economic double taxation that might otherwise occur if the US and the foreign country tax the same income in different taxable years.

The fact that the taxpayer did not leave the US in        does not necessarily mean he had no foreign source income in that year. For example, he might have reported income on the cash basis for work performed abroad in        for which he was paid in        . In addition, he might have paid or accrued foreign tax in        on income reported for US tax purposes in        . The source of income is generally determined under Code sections 861-865 and the regulations thereunder. Compensation for services performed in a foreign country may be treated as foreign source income under these rules. In addition, certain tax treaties may give US taxpayers the option to recharacterize some types of US source income as foreign source income to the extent necessary to relieve double taxation, if the income may be taxed by the foreign treaty partner as well as by the US.

When you get more information about the nature of the foreign source income reported by the taxpayer on his amended return for        , please feel free to contact me if you have followup questions about how the income was sourced or how the section 904 limitation was computed for that year. Thanks.